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COMMONWEALTH OF MASSACHUSETTS

BEFORE THE

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Investigation by the Department of Telecommunications)
and Energy on Its Own Motion into the Pricing and) D.T.E. 99-60-A
Procurement of Default Service Pursuant to G.L. c. 164, ?1B(d))

COMMENTS OF

WESTERN MASSACHUSETTS ELECTRIC COMPANY

INTRODUCTION

By Order dated May 12, 2000, the Department of Telecommunications and Energy (?Department?) issued a draft proposal addressing the pricing and procurement of default service and seven questions that the Department is seeking additional comments on. The Department conducted a technical conference on May 25, 2000 in which Western Massachusetts Electric Company (?WMECO? or the ?Company?) participated. At the May 25th technical conference, the Department gave the parties until May 31, 2000 to file written comments. WMECO respectfully provides the following comments on the Department?s draft proposal addressing the pricing and procurement of default service and the seven questions propounded by the Department.

OVERALL COMMENTS

WMECO agrees with the Department?s principles and the general overall approach contained in the Department?s Order. The Company?s overall goal is to eventually remove itself from the generation supply function to the maximum extent possible and to have energy provided by competitive suppliers. Default service should become, over time, a temporary bridge service for customers until the customer can obtain competitive generation service.

At some point in the future, it may be appropriate to tie true default service to ISO-NE?s market clearing prices, perhaps on a monthly basis. The transition to this future state should occur over the next three to four years, starting with monthly default service pricing in 2001, and more complex pricing enhancements (default service by rate class, retail adders) in 2002.

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In general, WMECO supports one-year default service solicitations in which customers can choose monthly pricing or an average, levelized price that could be for six months or longer with customer true-ups. This approach allows greater flexibility regarding when levelized billing can occur and be available, thus avoiding some of the customer access problems identified in the Department's Order. The annual solicitation process would contribute to the Department's goal of minimizing overall costs and takes full advantage of the competitive market.

Levelized prices for customers can best be accommodated by WMECO's billing system through budget billing (the customer pays a budget which would be based on the average of monthly prices, but would have the account charged with monthly prices subject to true-up at the end of the period or at the time of leaving default service). This method sends the appropriate price signals to customers because the monthly prices are shown on the customers bill. Currently, the Company's billing system is incapable of automatically back billing customers who leave default service for difference between monthly and average prices.

RESPONSES TO THE DEPARTMENT'S SEVEN QUESTIONS

WMECO offers the following comments responding to the Department's seven questions raised in its May 12, 2000 Order:

Q1: Are there data that demonstrate that the costs associated with providing default service will differ significantly among customer classes? If so, please provide a full description of such data and discuss the manner in which customer classes can or should be differentiated for the purpose of establishing different default service prices. Would such differentiation be consistent with or offensive to the statutory scheme for restructuring the electric industry?

A1: As a practical matter, the process cost for soliciting default service for all customers verses customer classes is not significantly different for the distribution company. While load profiles are different for different customer classes and could result in different pricing structures, sufficient data about market response to these profiles has not yet been developed (load data exists, but data does not exist on how competitive suppliers will differentiate among load groups, and whether they will take into consideration non-load factors such as switching likelihood). WMECO suggests that, if the Department ultimately decides to differentiate default service by rate class, a trial solicitation by rate class occur in 2002 or 2003.

Solicitations can be differentiated between 1) large commercial and industrial, 2) small commercial and industrial, 3) street lighting, and 4) residential. One cannot conclude that, just because retail competition for industrial customers is anticipated to be more robust than for residential customers, such a relationship will occur in the wholesale supply for default service. While common wisdom might expect that the residential customer class would receive the highest \$/kWh bid, such a result is uncertain.

The Act does not provide any specific guidance on whether differentiation is appropriate (e.g., universal service requirement under the Act does not imply equal price, existing ratemaking precedent suggests rates should be cost based). One issue that needs to be addressed is, if default prices are set by rate class, it could result in disparate overall rate levels among rate classes compared to current differentiation.

Q2: Are there data justifying more frequent solicitations for large commercial and industrial customers?

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A2: No, not in the near term. In fact, WMECO recommends solicitations for one-year periods for the next several cycles. Over the longer term, monthly default supply may be acquired (as a bridge default arrangement for customers who are between competitive suppliers).

More important than the length of the solicitation is the need to get prices at retail set on a monthly basis. Without this provision, there is no need to go to shorter solicitation periods.

WMECO applauds the Department's decision to go to monthly pricing. Six-month or more frequent solicitations can result in higher prices if market psychology responds to current events rather than future expectations (e.g., how would suppliers bid this Summer knowing that for some hours in May the price was \$6000/mWh?).

A one-year solicitation should help stabilize the price over the term (even though monthly pricing from that solicitation should be implemented) since there would be both peak and non-peak months within the year. Six-month solicitations run into being potentially more weighted with peak than non-peak months at times and visa versa at other times, thereby providing confusing price signals. Additionally, the more solicitations there are the more expensive the administrative costs will be and nothing more will be gained.

Q3: Are the distribution company's overhead and administrative costs per kWh associated with providing default service expected to be significant when compared to the bid price for default service? If the number of customers on default service increase significantly either during the transition period or at the end of the transition period when standard offer service is terminated, how would these overhead and administrative costs per kWh be affected?

A3: Incremental overhead and administrative costs per kWh associated with providing default service should not be significant (these costs should only be for employees doing the solicitations and administering the contracts). As a practical matter, costs to administer these solicitations is several hundred thousand dollars on an annual basis, compared to \$30 million or more for the default service currently and growing in the future. The goal should be to keep these costs as low as possible, again arguing for one-year solicitations for the next few years instead of shorter solicitations.

Q4: If a distribution company's overhead and administrative costs associated with providing default service were to be included in the price for default service paid by customers, how should these costs be estimated? Can these costs be quantified only in the course of a rate case proceeding?

A4: It would be a matter of accounting for the costs of the distribution company's activities in processing the solicitation. As part of the rate setting process that permits distribution companies to set default service rates under the Act, administrative costs can be set as part of the price.

WMECO agrees with the Department's statement that default prices should not be artificially inflated. However, if eventually it is decided to increase default service prices to encourage retail choice, then WMECO advocates the use of a stranded cost adder. The adder would be included on the default customer's bill (an administratively determined amount that could be the same or different across all customer classes and probably needs to be established based on the individual facts for each distribution company). The distribution company would use the excess (the adder less distribution company incremental costs) to offset the distribution company's stranded costs, which could be tracked in the annual transition charge reconciliations. This methodology would not require rate case proceedings.

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Q5: Does the Department's proposal sufficiently address concerns that competitive suppliers may seek to shift their customers to default service during peak months when the default service price is lower than prices available in the wholesale energy market? Are there ways that the proposal could be revised to better address these concerns?

A5: If the Department's proposal allows charging for monthly default pricing (in combination with six-month average pricing through budget billing with true-ups), the gaming issues should be substantially addressed. WMECO supports monthly default pricing beginning in 2001. The issue that has to be resolved is how monthly default pricing can be accommodated in overall rate design. If one assumes that, over the next few years, the supply cost for default (if bid on an annual basis) will be similar to standard offer cost, monthly default pricing on average should approximate the same overall price, however, it would also have monthly swings that would vary from standard offer.

Q6: Are the default service prices established according to the Department's proposal an appropriate indicator of average monthly market prices? Does this interpretation meet the Act's requirements?

A6: Yes, soliciting bids on a monthly basis is, by definition, an indicator of average monthly prices called for in the Act (the market responds by bidding monthly prices into the RFP). By requiring a competitive solicitation in which suppliers must bid monthly prices, the Department has fulfilled the requirement of having an appropriate indicator of average monthly market prices.

Q7: Please discuss in specific detail what function, if any, the Department should have in overseeing default service procurement.

A7: WMECO agrees with the Department's proposal to monitor the default service process, but not to interfere with the distribution company's solicitation process and selection of the winning bidder. In situations where affiliates may be bidding into the RFP, the distribution company must adopt procedures, reviewed by the Department, to assure appropriate protections regarding code of conduct.